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RUEHUJA/AMEMBASSY ABUJA 2250
RUEHAR/AMEMBASSY ACCRA 2726
RUEHDS/AMEMBASSY ADDIS ABABA 2848
RUEHBY/AMEMBASSY CANBERRA 2113
RUEHDK/AMEMBASSY DAKAR 2469
RUEHKM/AMEMBASSY KAMPALA 2896
RUEHNR/AMEMBASSY NAIROBI 5335
RUEAIIA/CIA WASHDC
RUEHGV/USMISSION GENEVA 2015
RHEHAAA/NSC WASHDC
RHMFISS/JOINT STAFF WASHDC
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEFDIA/DIA WASHDC
RUCPDOC/DEPT OF COMMERCE WASHDC
RUZEJAA/JAC MOLESWORTH RAF MOLESWORTH UK
RUZEHAA/CDR USEUCOM INTEL VAIHINGEN GE

UNCLAS SECTION 01 OF 03 HARARE 000260

SENSITIVE
SIPDIS

AF/S FOR B. WALCH
AF/EPS FOR ANN BREITER
NSC FOR SENIOR AFRICA DIRECTOR
STATE PASS TO USAID FOR L.DOBBINS AND J. HARMON
TREASURY FOR D. PETERS
COMMERCE FOR ROBERT TELCHIN
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS

E.O. 12958: N/A
TAGS: EFIN ECON PGOV ZI
SUBJECT: BITI INTRODUCES MORE REALISTIC CASH BUDGET

REF: A. HARARE 282
¶B. HARARE 077

SUMMARY

¶1. (SBU) New Minister of Finance Tendai Biti presented a revised budget to Parliament on March 18, 2009. About half the size of the previous budget prepared by Acting Minister of Finance Patrick Chinamasa, Biti's cash budget, at US$1 billion, may still be optimistic in its revenue projection. The budget supports market-friendly policies, which, if implemented consistently, should result in economic growth this year. Since the formal acceptance of trading in hard currencies in February, the economy has stabilized considerably: hyperinflation has ended, most shops are restocking, and prices are gradually falling. We expect to see production improve in the medium to long term as confidence returns. In the meantime, the knottier problem is how to manage Zimbabwe's current acute shortfall in foreign exchange. END SUMMARY.

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Unrealistic January 2009 Budget and Biti's Revision
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¶2. (U) The 2009 budget presented to Parliament on January 29, 2009 by Chinamasa was based on total expenditure of US$1.9 billion and an overly optimistic assumption on revenue of US$1.7 billion, averaging US$142 million a month. Chinamasa also estimated that Zimbabwe would get US$200 million from donors resulting in a balanced budget for the first time in the country's history (Ref B).

¶3. (U) New Minister of Finance Tendai Biti presented a revised budget of US$1 billion to Parliament on March 18, 2009, based on positive revenue collection trends in January and February. The new budget also takes into account seven additional Ministries agreed to under the Global Political Agreement (GPA), which had not been included in the January budget.

Budget Highlights

¶4. (U) Highlights of the revised budget:

-- A 47.4 percent reduction in expenditure from US$1.9 billion to US$1 billion. In view of the adoption of cash budgeting, the projected revenue is also 41.2 percent less than in Chinamasa's budget (US$1 billion, down from US$1.7 billion).

-- Recurrent expenditure to account for just over 80 percent of total expenditure, with capital expenditure and net lending to local authorities and parastatal bodies accounting for the remainder. The recurrent budget is dominated by employment costs, which account for 34.5 percent, with the remainder dominated by operations and pensions. For the first time in years, the budget allows for interest payments of some US$16.7 million on foreign debts.

-- The ministries of education and health together account for 38.3 percent of total appropriations, while defense is allocated 6.3 percent and home affairs accounts for 7.1 percent of the total. Agriculture, on the other hand is allocated just 4.6 percent of the budget and mining a mere 0.5 percent.

-- Taxes on goods and services are estimated to account for 61 percent of total revenue, including customs duties accounting for 28.5 percent of total revenue and VAT set to account for 26.5 percent.

-- Taxes on income and profits are projected to account for 32.8 percent of total revenue. Taxes on individuals, at 12 percent of total revenue, are expected to be fractionally higher than corporate taxes at 11.7 percent.

-- The special tax on deposits introduced by Chinamasa is revoked since it was to be levied on Zimbabwe dollar denominated deposits.

-- Adoption of multiple currencies but takng the rand as a reference currency.

-- Abolition of quasi-fiscal expenditures and no printing of money to fund government expenditure.

-- Removal of dual pricing in foreign exchange and in Zimbabwe dollars since it is acknowledged that the Zimbabwe dollar is effectively worthless.

-- Foreign exchange surrender requirements of between 5 and 7.5 percent scrapped because of their negative effect on production.

-- Introduction of flat duty rates and a general reduction from as high as 65 percent to 40 percent on goods that are not accommodated in the travelers' rebate of US$300 per calendar month.

-- Upward review of royalties and taxes on mining houses to offset loss of revenue on surrender requirements.

Major Improvement in Economic Policy

¶5. (SBU) The revised 2009 budget is a major policy improvement. For a start, its revenue assumption is based on extrapolation from actual collection trends in the first two months of the year rather than as a proportion of a Gross Domestic Product (GDP) figure plucked out of the air. Chinamasa had estimated GDP for 2009 at US$5.5 billion, whereas the IMF recently suggested it could be about US$3.2-US$3.3 billion (Ref A). Coming out of hyperinflation and with the erosion and politicization of the Central Statistical Office in recent years, no one knows for sure. Despite this improvement, members of the recent IMF Mission suggested that the government's revenue projection was high. We expect their staff report to project a $200 million deficit.

¶6. (SBU) The revised budget introduces numerous positive policies that will likely generate a significant supply

response if implemented consistently. The removal of both price controls and the surrender requirements for exporters and merchants, for example, eliminated significant implicit taxes on production and the anti-export bias of the past. Exporting should now be more profitable. Given Zimbabwe's dire lack of foreign exchange and inability to access balance of payments support, higher levels of exports could contribute significantly to building up foreign reserves.

¶7. (SBU) Budget allocations to critical ministries that have the potential to generate foreign exchange, such as agriculture and mining, are noticeably low relative to the ministry of defense's allocation. Consequently, recovery in those two key sectors will have to be private-sector led, which could happen in the mining sector, but is less likely to occur in the still very troubled agricultural sector.

¶8. (SBU) Far higher amounts of money are needed for capital expenditure than allocated in the budget. To close the gap, Zimbabwe must re-engage with the international community. Re-engagement with the international financial institutions is closely tied with developing a credible plan to clear arrears. In this regard, it is noteworthy that the revised budget allocates interest payments on foreign debt. Although the amount hardly dents the stock of Zimbabwe's external debt, it is a significant step forward in regaining investor confidence.

¶9. (SBU) Dollarization of the economy has slain hyperinflation. The demise of the Zimbabwe dollar also ended the Reserve Bank's ability to print money with reckless abandon and buy foreign exchange. Hard-currency prices of basic commodities are still above regional averages, but merchants are restocking and people are shopping again. While most companies in the productive sector are still operating at only around 10 percent capacity, we expect to see production improve in the medium to long term as the implementation of market-friendly policies restores confidence to industry. In the meantime, the knottier problem facing Zimbabwe and donors alike is how to manage Zimbabwe's immediate shortfall in foreign exchange.

DHANANI